

Message Text

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PAGE 01 BUENOS 05051 081517Z
ACTION EB-07

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E.O. 11652: N/A
TAGS: EFIN, ETRD, AR
SUBJECT: PRICE TRUCE ENDS; NEW PRICE CONTROL SYSTEM ANNOUNCED

SUMMARY: THE 120-DAY PRICE TRUCE ENDED JULY 7 BUT WAS REPLACED BY A NEW PRICE CONTROL REGIME PEGGED TO THE DEVALUATION OF THE PESO. FIRMS AND PRODUCTS WILL BE GRADUALLY REMOVED FROM THE PRICE CONTROL REGIME BASED ON AN ASSESSMENT OF COMPETITIVE MARKET CONDITIONS. THE GOA'S USE OF TARIFF REDUCTION AS AN ANTI-INFLATIONARY INSTRUMENT HAS PROVOKED SOME POLICY DISAGREEMENT AMONG MEMBERS OF THE ECONOMIC TEAM, AS WELL AS OPPOSITION FROM DOMESTIC INDUSTRIAL CIRCLES.
END SUMMARY

1. THE 120-DAY PRICE TRUCE ENDED OFFICIALLY JULY 7 BUT WAS REPLACED BY A NEW PRICE CONTROL REGIME AFFECTING A RELATIVELY SMALL NUMBER OF LEADING FIRMS AND PRODUCTS. ACCORDING TO THE NEW SYSTEM, FIRMS STILL SUBJECT TO PRICE CONTROLS MAY RAISE THEIR PRICES AUTOMATICALLY BY A PERCENTAGE EQUAL TO 80 PERCENT OF THE DEVALUATION OF THE FREE MARKET PESO (SELL QUOTATION) IN RELATION TO THE DOLLAR. IF THEIR COSTS HAVE RISEN MORE THEN THIS PERCENTAGE, THESE FIRMS MAY
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PAGE 02 BUENOS 05051 081517Z

REQUEST AUTHORIZATION FROM THE SECRETARIAT OF COMMERCE TO RAISE THEIR PRICES BY A LARGER AMOUNT.

2. IN STATEMENTS TO THE PRESS, SECRETARY OF COMMERCE ALEJANDRO ESTRADA HAS EMPHASIZED THAT THE EXISTENCE OF A COMPETITIVE MARKET IS THE MAJOR FACTOR DETERMINING WHICH FIRMS OR PRODUCTS STILL HAVE TO BE SUBJECTED TO

PRICE CONTROLS. FIRMS HAVING SUFFICIENT DOMESTIC COMPETITION HAVE BEEN REMOVED FROM THE LIST OF THOSE SUBJECT TO CONTROLS; OTHERS, ENJOYING A PREDOMINANT SHARE OF THE LOCAL MARKET, HAVE BEEN EXCLUDED AFTER EXTERNAL TARIFFS HAVE BEEN LOWERED, THUS EXPOSING THEM TO THE THREAT OF FOREIGN COMPETITION SHOULD THEIR PRICES RISE TOO HIGH. THE NUMBER OF FIRMS SUBJECT TO PRICE CONTROLS HAS ALREADY BEEN REDUCED FROM THE ORIGINAL 724 TO 460 AND ESTRADA ESTIMATES THAT THE NUMBER WILL FALL TO AROUND 200 BY SEPTEMBER.

3. ESTRADA'S USE OF TARIFF REDUCTION AS AN ANTI-INFLATIONARY INSTRUMENT HAS APPARENTLY PROVOKED SOME POLICY DISAGREEMENT AMONG MEMBERS OF THE ECONOMIC TEAM, WITH SECRETARY OF PLANNING AND COORDINATION GUILLERMO KLEIN SUPPORTING ESTRADA'S POSITION AND SECRETARY OF FOREIGN COMMERCE ALBERTO FRAGUI AND SECRETARY OF INDUSTRY RAYMUNDO PODESTA IN OPPOSITION. ALTHOUGH SECRETARY KLEIN HAS PUBLICLY DENIED ANY POLICY DIFFERENCES, SOURCES CONFIRM THAT THERE HAVE BEEN HARD FEELINGS OVER THE MANNER IN WHICH RECENT TARIFF REDUCTIONS WERE IMPLEMENTED. REPORTEDLY, SECRETARY KLEIN TOOK ADVANTAGE OF SECRETARY FRAGUI'S ABSENCE ON A TRIP TO HOLLAND TO HAVE HIMSELF APPOINTED ACTING SECRETARY OF FOREIGN COMMERCE (FRAGUI HAD LEFT SUBSECRETARY PAZOS IN CHARGE) AND APPROVED A SERIES OF LIMITED OFFICIAL USE

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PAGE 03 BUENOS 05051 081517Z

TARIFF REDUCTIONS RECOMMENDED BY SECRETARY ESTRADA. FRAGUI WAS ALLEGEDLY ANNOYED AT KLEIN'S INCURSION INTO HIS OFFICE AND BOTH FOREIGN COMMERCE SUBSECRETARIES PAZOS AND BAUERLE TOOK ADVANTAGE OF THE INCIDENT TO RESIGN (THE FACT THAT THEY ARE REMAINING AS CONSULTANTS TO FRAGUI SUGGESTS THAT THE RESIGNATIONS MAY HAVE BEEN PRIMARILY MOTIVATED BY SALARY CONSIDERATIONS). IN ADDITION, SOURCES INDICATE THAT, ALTHOUGH FRAGUI AND PODESTA ARE NOT OPPOSED IN PRINCIPLE TO TARIFF REDUCTIONS, THEY BELIEVE THAT THE IMPACT ON PRICES SHOULD NOT BE THE ONLY CONSIDERATION. FRAGUI, IN PARTICULAR, REPORTEDLY ADVOCATES TRYING TO OBTAIN CONCESSIONS FROM OTHER COUNTRIES IN RETURN FOR REDUCING ARGENTINA'S TARIFFS.

5. PRELIMINARY REACTION FROM THE BUSINESS CIRCLES TO THE NEW PRICE CONTROL SYSTEM IS NEGATIVE. BUSINESSMEN POINT OUT THAT THE GOA DETERMINES DIRECTLY THE RATE OF DEVALUATION OF THE PESO AND, ALTHOUGH THE RATE MAY HAVE A ROUGH RELATIONSHIP WITH THE EVOLUTION OF INTERNAL PRICES, IT HAS BEEN ADJUSTED AS A SLOWER PACE THAN EITHER THE WHOLESALE OR CONSUMER PRICE INDEX. THEREFORE,

UNLESS THE SECRETARIAT OF COMMERCE APPROVES RAPIDLY REQUESTS FOR PRICE INCREASES BASED ON INCREASED COSTS, FIRMS SUBJECT TO PRICE CONTROLS ARE LIKELY TO CONTINUE TO SEE THEIR PROFIT MARGINS SQUEEZED AND PARTICULARLY THOSE HIGHLY DEPENDENT ON SUPPLIERS NOT SUBJECT TO CONTROLS (E.G. AUTO INDUSTRY). THEY ARE ALSO VERY CONCERNED ABOUT ESTRADA'S USE OF TARIFF REDUCTIONS TO PLACE A CEILING ON PRICES AND BELIEVE THAT IT IS IN-APPROPRIATE TO EXPOSE DOMESTIC INDUSTRY TO INCREASED COMPETITION WHILE IT IS TRYING TO RECOVER FROM THE CURRENT RECESSION.

5. COMMENT: WHILE ESTRADA'S ANTI-INFLATIONARY POLICIES HAVE STIRRED UP A HORNET'S NEST, HE APPEARS TO HAVE THE LIMITED OFFICIAL USE

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PAGE 04 BUENOS 05051 081517Z

SUPPORT OF MINISTER OF ECONOMY MARTINEZ DE HOZ. THE 80 PERCENT FORMULA FOR ADJUSTING PRICES AUTOMATICALLY UNDER THE NEW PRICE CONTROL SYSTEM IS SOMEWHAT ARBITRARY, AS IS ADMITTED BY A GOA SOURCE, AND REPRESENTS MERELY A DESIRE TO AVOID INSTITUTIONALIZING A HIGH LEVEL OF INFLATION. THUS FAR, THE TARIFF REDUCTIONS HAVE MAINLY REDUCED EXCESS PROTECTION FOR A WIDE RANGE OF PRODUCTIONS AND AT THIS POINT SHOULD NOT EXPOSE DOMESTIC SUPPLIERS TO ANY SIGNIFICANT INCREASE IN FOREIGN COMPEITION. SINCE ONLY 25-30 PERCENT OF THE PRODUCTS SUBJECT TO PRICE CONTROLS ARE REFLECTED IN THE PRICE INDEXES, THE IMPACT OF THE NEW SYSTEM ON INFLATION IN JULY IS APT TO BE MINIMAL. CHAPLIN

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